coverage. James Horan, a certified public accountant, speaking on behalf of ARRM, suggested that this item be eliminated. He could not think of any examples of indirect costs, and since no examples of "generic supplies" were set forth in the rule, he concluded that it is unnecessary. In the Department's post-hearing response to his comment, it noted that all cost categories have a line item for supplies. The supplies associated with a specific cost category must be recorded under the supply line item in that cost category. However, it noted that there are generic supplies such as paper or supplies used by a copy machine which are used by many departments. The cost of such generic supplies must be reported in the supply line item of the administrative cost category without allocation. It is necessary and reasonable to require that generic supplies used by many departments be reported to the administrative cost category as required under the rule because such a requirement will result in the uniform treatment of costs by all facilities and will generate accurate cost data for purposes of comparing costs between facilities. Therefore the rule may be adopted. However, the Department should consider replacing the words "specifically classified" with the words "directly identified" (page 8, line 30). Such a change is not substantial and appears to be more consistent with the concepts of identification, classification and allocation.

9553.0030, subp. 1, item C.

33. This item requires the allocation of compensation paid to persons having multiple duties. Provided that the person is not in top management, the person's salary must be classified to the cost categories where the work is performed on the basis of time distribution records that show actual time spent or an accurate estimate of time spent on various activities. If a facility elects to estimate the time spent by employees in various cost categories, it must use a statistically valid method for reaching the estimate used. The rule requires that persons who serve in a dual capacity, including those who have only nominal top management responsibilities, directly identify their salaries to the appropriate cost categories. The requirements mentioned above are necessary and reasonable and may be adopted.

In its original form the rule permitted the allocation of the salaries of top management personnel only by facilities or provider groups having 48 or fewer licensed beds. The Department now proposes to include restrictions on the allocation of the salaries of top management personnel in a new item D which is discussed below. Due to the separate treatment of top management salaries in a new item, some language was deleted from item C. As amended, and subject to the limitations in item D, item C permits part of the compensation paid to a person in top management to be classified to cost categories other than the administrative cost category. The classification of top management compensation to other cost categories is available only if supported by time distribution records or accurate estimates of the time spent in the various cost categories. The amendments made to item C were not substantial for purposes of Minn. Rule 1400.1100 and that item, as amended, is necessary and reasonable. However, it is suggested that it be rewritten to read as follows:

> Except for persons in top management, the compensation of any person having multiple duties, including persons who have only nominal top management responsibilities, must be

directly identified and classified to the appropriate cost categories on the basis of time distribution records that show actual time spent, or an accurate estimate of time spent on various activities. Except as provided in item D, the compensation of persons who have top management responsiblilities may be classified to a cost category other than administrative operating costs to the extent justified in time distribution records showing the actual time spent, or an accurate estimate of time spent on various activities. Any facility or provider group choosing to estimate the time spent in different cost categories must use a statistically valid method.

The amended language eliminates references to "personnel" and "salary". Those words appear to be too restrictive.

34. Several persons objected to item C because they felt that the words "nominal" and "a statistically valid method" are too ambiguous. Those objections have no merit. The Commissioner has recognized that persons who perform only "nominal" top management duties are not top management personnel. See, In the Matter of the Contested Case of Crestview Manor, Inc., DPW-84-013-JL, Order of the Commissioner, p. 9, August 1, 1984. A nominal duties test is necessary under this rule because it is not feasible to adopt a more precise standard. A case-by-case approach is necessary because the nature, quantity and quality of the duties of a particular individual will vary considerably from one situation to another. Similary, the reference to a "statistically valid method" is not impermissibly vague. Since the Department has not specified a methodology to follow, providers may devise one which is relevant to their organization. This flexibility is probably necessary and will permit a provider to choose any methodology that is statistically accurate. It is not required to be the most accurate methodology.

9553.0030, subp. 1, item D.

35. This item was proposed for adoption in the Department's initial post-hearing comment. It is designed to replace language previously contained in item C, which limited the allocation of top management salaries to facilities or provider groups having 48 or fewer licensed beds, and which prohibited the allocation of the salary of any person having more than nominal top management responsibilities. It reads as follows:

> D. The salary of a person who is classified as top management personnel and who performs any service for the central, affiliated, or corporate office must be allocated to the facility's administrative cost category in accordance with subpart 4, item C if the facility or provider group served by the central, affiliated, or corporate office has more than 48 licensed beds.

This amendment was proposed by the Department in response to widespread criticism of its initial proposal to prohibit facilities or provider groups with more than 48 beds from allocating a top management employee's salary. Under the amended rule, a facility or provider group with 48 licensed beds or less will be permitted to allocate any top management employee's salary among

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cost categories. However, if the facility or provider group has more than 48 licensed beds it will be permitted to allocate a top management employee's salary only if that employee does not perform any service for a central, affiliated or corporate office. The Department has determined that if it were to allow the allocation of top management salaries for persons performing general executive functions at the central office in a provider group of more than 48 beds, the top management limitation provisions in the proposed rule could be easily circumvented, resulting in increased costs to the state and no increased benefits. The decision to prohibit allocation for top management employees who have executive duties in the central office of a provider group of more than 48 licensed beds is necessary and reasonable to eliminate abuses in the reimbursement of top management personnel, which the Department has a limited ability to verify, as was recognized in Matter of Crestview Manner, Inc., 365 N.W.2d 387, 390 (Minn.App. 1985).

It was also suggested that the rule is not needed because no evidence was presented showing that any abuses have occurred in the classification of top management salaries. Even if there have been abuses, it was argued that honest providers should not be punished because abuses can be corrected in other ways, including prosections for fraud. Those are relevant considerations. However, the Department has concluded that the salaries of top management personnel who provide services to central offices cannot be allocated because of its limited ability to verify the allocations made or to detect abuses. Its policy choice is reasonable. It is also necessary. The Department is not required to wait for abuse to occur before taking steps to prevent them, or to create a system that can be abused when such abuse may not be discoverable.

9553.0030, subp. 2, Allocation of Personal Expenses.

36. This subpart contains the allocation procedures that are to be followed when the facility is also the primary residence of an owner. The purpose of this subpart is to separate an owner's personal expenses from the facility's expenses so that the personal expenses are not reimbursed under the Medical Assistance program. It contains procedures for determining the allocation of property costs as well as operating costs which are to be treated as the personal expenses of the owner and not reimbursable to the provider. The provisions in this subpart were not subject to adverse public comment and they are necessary and reasonable as proposed. The Medical Assistance program is not designed to reimburse an owner's personal living expenses.

9553.0030, subp. 3, Cost Allocation for Other Services.

37. This subpart governs the allocation of costs associated with services other than ICF/MRs services, such as apartments, semi-independent living services, and other revenue-generating operations except respite care. It requires that they be classified pursuant to subpart 1 and allocated just as the personal expenses of owners would be allocated under subpart 2. The rule proposed was not subject to adverse public comment and is necessary and reasonable. The rule is designed to provide reimbursement for ICF/MR services only and not to reimburse facilities for costs incurred for the provision of other services which may be reimbursed under other programs or from other sources.

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9553.0030, subp. 4, Central, Affiliated and Corporate Office Costs.

38. This subpart regulates the allocation of central, affiliated, or corporate office costs to the specific cost categories of each facility. General allocation procedures for central, affiliated, or corporate office costs are necessary and reasonable because the rates established under the rule are facility specific and only those cost necessarily incurred to operate a facility are allowable. In addition, such procedures are needed to prevent cost shifting when one facility has exceeded its limits and another facility has not. The rule also prevents the allocation of costs to a facility which are unrelated to ICF/MR services. For these reasons the provisions in this subpart are generally needed and reasonable.

9553.0030, subp. 4, item A.

39. This item governs the allocation of the salary expenses of consultants required by law. It provides that they may be allocated to the appropriate facility's cost category but only to the extent that they are directly identified by the facility. This is a necessary and reasonable provision because it permits facilities to recover the actual costs they incur for consultants in caring for mentally retarded residents.

9553.0030, subp. 4, item B.

40. This item governs the allocation of the compensation of consultants employed by corporate offices but whose services are not required by law. It permits the allocation of the salaries, fringe benefits and payroll taxes of such consultants if they can be directly identified, but only to the extent justified in time distribution records which show the actual time spent by the consultant performing services in a particular facility. The rule permits a provider to allocate the salaries of individuals actually working in ICF/MRs even though their salary is, as a matter of convenience, paid by the central office. It requires that the consultant's salary, fringe benefits and payroll taxes be allocated to only one operating cost category in a facility, and if more than one facility is served by the consultant, the facilities must allocate the consultant's compensation costs to the same operating cost category. For purposes of this item, top management personnel cannot be treated as consultants and the consultant's entire job responsibility must be to provide consulting services to facilities. In order to properly classify costs and avoid improper cost shifts the rule is necessary and reasonable as proposed.

41. Mr. Horan suggested that subitem (1) should permit the allocation of all the costs of employees having program-related duties to the facilities. He noted specifically the in-service training of program staff provided by some central offices. He argued that the costs of such in-service training should be allowed to be allocated to the facilities in the program category where the benefits are directly derived. He suggested that past practice be followed under which the allocation would be based on resident days. As noted in the Department's post-hearing comment (No. 7) the salary, fringe benefits and payroll taxes of persons providing in-service training to an individual facility may be allocated. The Department has concluded that allowing the allocation of costs other than salaries, fringe benefits and payroll taxes would give chain organizations an undue advantage over free-standing

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facilities by permitting them to treat some costs as program costs when other facilities are required to treat them as administrative costs. For the reasons stated by the Department it is concluded that its decision to limit allocation to salaries, fringe benefits and payroll taxes is necessary and reasonable in order to obtain accurate cost figures and uniform treatment.

An ARRM representative suggested that subitem (2) be amended to permit the classification of a consultant's costs on the basis of resident days. Such an amendment would avoid the need to keep detailed time distribution records and should produce relatively accurate results that would be difficult to manipulate. Although subitem (2) is necessary and reasonable as proposed, it is recommended that ARRM's amendment be considered. Such an amendment would be reasonable and necessary and would not constitute a substantial change for purposes of Minn. Rule 1400.1100. In addition, the Department should reconsider subitem (5) in view of its amendment to part 9553.0030, subp. 1, which added item D. If some top management persons can classify their compensation to more than one cost category, less restrictive limitations on top management personnel who act as consultants may be appropriate.

9553.0030, subp. 4, item C.

42. This subpart governs the allocation of central, affiliated and corporate office costs other than the salaries of consultants. It requires allocation in five sequential steps. All costs which can be directly identified with a specific facility must be allocated to that facility; costs that can be directly identified with an operation unrelated to a facility must be allocated to that unrelated operation; and then all costs which cannot be directly identified to a facility must be allocated between facility operations and unrelated operations based on the ratio of the expenses attributable to each category. Once the costs of facility operations are determined, those costs must be allocated between facilities within and without the State of Minnesota based on the ratio of total resident days in Minnesota facilities to resident days in facilities in other states. Then the facility-related costs of the central office must be allocated to facilities within the State of Minnesota based on resident days. This is a necessary and reasonable way of isolating the costs incurred by a central office on behalf of Minnesota ICF/MRs and for determining the costs that should be considered in calculating reimbursement rates under the state's Medical Assistance program.

9553.0030, subp. 4, item D.

43. This item governs the classification of the property-related costs of capital assets incurred by central, affiliated or corporate offices. If the capital asset is used directly by a facility to provide ICF/MR services, the cost must be classified to the user facility. If the capital asset is not used directly by a facility to provide ICF/MR services, the cost must be allocated to the administrative cost category of the relevant facilities using the procedures in item C. This is a necessary and reasonable provision which permits the costs of assets used directly by facilities to be classified as they would be if they had been purchased by the facility. Those capital assets which are not directly used by facilities and treated as administrative costs are not included in the investment per bed limit or considered in

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determining equity. Since there were questions on that point the Department has proposed an amendment to part 9553.0060, subp. 1, item C which is discussed in connection with that provision.

Mark Larson, counsel for REM, Inc., argued that this item does not clearly explain whether the costs of capital assets used directly by a facility are to be treated as a property-related cost of the facility or whether they remain in the facility's administrative cost category. Although the Department apparently intends to have those costs classified in the property-related cost category, which would be necessary and reasonable, the rule is insufficiently specific on that point, contrary to Minn. Stat. § 14.02, subd. 4. This constitutes a substantive violation of law for purposes of Minn. Stat. § 14.50. To correct this defect the rule must clarify the cost category to be used for assets used directly by facilities.

9553.0030, subp. 4, item E.

44. This item governs the calculation of the useful life of capital assets maintained by corporate offices. The rule originally proposed would have required facilities to establish the useful life of depreciable equipment using the depreciation guidelines of the American Hospital Association. In response to comments from Mr. Horan and Ms. Martin regarding the additional record keeping the rule would require, the Department has determined that item E should be amended to read as follows:

> E. The useful life of a capital asset maintained by a central, affiliated, or corporate office must be determined as in part 9553.0060, subpart 1, item B except that useful life of depreciable equipment except vehicles must be ten years.

The rule as amended is necessary and the amendment made does not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985). However, the useful life of the equipment of a facility is five years under 9553.0060, subpart 1, item B, subitem (d). The reason for this difference was not questioned or explained and it must be changed. It was not shown that the useful life of depreciable equipment should vary with its use in a facility or in a central office. Therefore, the differing treatment accorded to such equipment was not shown to be reasonable. This constitues a violation of Minn. Stat. § 14.14, subd. 2. To correct this defect, a 5-year useful life figure must be used.

9553.0030, subp. 6, Payroll Tax and Fringe Benefit Cost Allocation.

45. As originally proposed this subpart required the allocation of payroll taxes and fringe benefits to operating cost categories based on the ratio of allowable salary costs in each of those cost categories to total allowable salary costs. Several commentators suggested that since payroll taxes, unemployment taxes, and worker's compensation costs are not directly related to a person's salary level and are capped at various amounts, that facilities should be permitted to directly identify payroll taxes and fringe benefits to the appropriate operating cost category when their records permit such an identification. In response to those suggestions, the Department proposes to amend subpart 6 to read as follows:

A facility's payroll taxes and fringe benefits reported in the payroll taxes and fringe benefit cost category must be classified to the program operating cost category, the maintenance operating cost category, and the administrative operating cost category based on direct identification or an allocation using the ratio of allowable salary costs in each of those cost categories to total allowable salary costs.

The amendment proposed by the Department is necessary and reasonable because it permits facilities having the necessary records to make a more accurate distribution of payroll taxes and fringe benefit costs among the various operating cost categories. For that reason the rule, as amended, is necessary and reasonable, and since the amendment proposed does not constitute a substantial change for purposes of Minn. Rule 1400.1100 (1985), the amendment may be adopted.

DETERMINATION OF ALLOWABLE COSTS

9553.0035, subp. 1, Allowable Costs.

46. Part 9553.0035 defines and limits the costs that are allowable in determining an ICF/MR's payment rate. Rules regulating the calculation of allowable costs are required under Minn. Stat. § 256B.501, subd. 2, which mandates that the Commissioner adopt rules specifying the costs that are allowable for payment under the Medical Assistance program. Under subdivision 3 of the statute, the rules governing payment rates must be based on methods and standards that are adequate to provide for the costs that must be incurred for the care of residents in efficiently and economically operated ICF/MRs. These statutory criteria and the other specific considerations and objectives stated in the statute must be used in considering the need and reasonableness of the allowable costs specified in the rules.

0553.0035, subp. 2, Licensure and Certification Costs.

47. Under this subpart the costs that must be incurred to meet licensure and certification standards are allowable costs for purposes of setting an ICF/MRs total payment rate. The allowable costs of that nature include those incurred to comply with federal regulations governing ICF/MR services; program standards and standards for aversive and deprivation procedures established by the Commissioner; health standards established by the Minnesota Department of Health; changes in federal or state laws and regulations; and licensing standards in federal or state law, state rules, federal regulations or local ordinances that must be met to provide ICF/MR services. The costs allowed under subpart 2 are those that must be incurred by ICF/MRs. The provisions of this subpart were not subject to any adverse public comment and they are necessary and reasonable as proposed.

9553.0035, subp. 5, Adequate Documentation.

48. This subpart specifies the record keeping requirements that are required to verify the costs claimed by a facility for purpose of computing its payment rate. The Commissioner has authority to impose record keeping requirements on providers claiming reimbursement from the Medical Assistance

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program under Minn. Stat. §§ 256B.501 and 256B.27. In order to verify the costs claimed by ICF/MRs and to carry out his statutory responsibilities, the Commissioner clearly has authority to require that the costs claimed by an ICF/MR be supported by adequate documentation that can be examined in the audit process. It is essential, therefore, that he adopt rules regulating the documentation and records that must be maintained.

9553.0035, subp. 5, Item A.

49. Under subpart 5 facilities are required to keep adequate documentation supporting any costs claimed. To be adequate, the documentation must be maintained in orderly, well-organized files. One set of files cannot include documentation for more than one facility unless transactions may be traced to the facility's annual cost report. Proper documentation consists of a paid invoice or copies of paid invoices showing dates of purchase, vendor name and address, purchaser name and delivery address, a listing of items or services purchased, the cost of items purchased, the account number to which the cost is posted, and a breakdown of any classification or allocation of costs between accounts or facilities. In addition, adequate documentation must include the contracts, agreements, amortization schedules, mortgages, debt instruments and other documents necessary to explain the facility's costs or revenues. These requirements were shown to be necessary and reasonable. Although some persons question whether the provisions in subpart 5 are not duplicative of the reporting requirements contained in part 9553.0041, no unnecessary duplication exists. Part 9553.0041 specifies the information that facilities must file with the Department with their annual cost reports. It does not generally regulate the kind of documentation a facility must maintain to support the costs claimed and which must be available if the Department is to conduct an expeditious and reliable field audit. However, the Department should consider clarifying the language in subpart A(3). The sentence beginning on page 14, line 11 is incomplete, therefore, it is suggested that the Department add the words "to be" at the end of line 11.

50. Subitems (4) and (5) were the only controversial portions of item A. Subitem (4) requires that "all other documents necessary to explain the facility's costs or revenues" be maintained. Louis M. Furlong, attorney at law, argued that the quoted language is impermissibly vague and should be deleted because the Department has traditionally made unreasonable and redundant document requests in order to delay fixing final rates. Mr. Furlong's comment raises several issues that should be addressed. First, the deletion he requested will not necessarily relieve the problem he alleged. During an audit, it is doubtful that the Department is limited to an examination of only those records facilities are required to keep under the rule. Even if it is, in determining whether the rule is sufficiently specific, the inquiry is not whether the rule could be used for an improper purpose -- as most rules could be abused -- but to determine whether the language of the rule gives reasonable notice of the documentation required. What is reasonable depends, in part, on whether more clarity is feasible. However, under those standards, it is concluded that the quoted language is not sufficiently specific for purposes of the Administrative Procedure Act. As such, the requirements constitutes a substantive violation of law for purposes of Minn. Stat. §§ 14.02, subd. 4 and 14.50 (1984). To correct this defect the Department may delete the objectional language or add clarifying language as is discussed below.

51. The type of documentation needed as well as the meaning of the rule is unclear. As to revenue items, the kind of information needed or the manner in which it is to be documented is not explained. A provider would be unable to determine if he must identify the name of the payor, the reason for payment, or some additional information. Moreover, a provider cannot determine how that information is to be documented or if identification using generally accepted accounting principles or journal and ledger entries would satisfy the requirement.

In addition, it is unclear whether a cost item that is covered by an invoice or a contract will ever need additional documentation. While it appears that the Department intended the language to be used as a catchall when invoices and contracts do not explain a cost or revenue item, the rule is not specific on that point and must be clarified. Moreover, the disjunctive word "or" on line 16 should be changed to "and." Thus, the Department could replace subitem (4) with the following:

> (4) include copies of all written agreements and debt instruments to which the facility is a party and any related mortgages, financing statements and amortization schedules, to explain the facility's costs and revenues; (5) if a cost or revenue item is not documented under subitems (3) or (4), the facility must document the amount, source and purpose of the item in its books and ledgers following generally accepted accountng principles and in a manner providing an audit trail.

52. Under subpart A(5) a facility must maintain the documentation specified in the rule to support the five most recent annual cost reports submitted to the Commissioner. The rule provides that the Commissioner may extend the retention period if a field audit is postponed because of inadequate record keeping or accounting practices as set forth in part 9553.0041, subp. 12, or if the records are needed to resolve a pending appeal. The rule is generally intended to require facilities to keep the supporting documentation for the current year and the four preceding cost reporting years. After the cost report for the current year has been received and desk audited, the supporting documentation for the latest cost reporting year would no longer have to be maintained. Eileen Harris suggested that the starting date for record retention under the rule coincide with the first report submitted under it. At a minimum she suggested that the Department clarify the number of years records should be retained under Rule 52 and the proposed rule. Since the rule states that cost reports and supporting documentation must be retained to cover the five most recent annual cost reports, it is apparently intended to cover reports filed under Rule 52 or Rule 53T if they were within the five-year requirement. The rule does not require that providers retain the five most recent annual cost reports filed under Rule 52. Since the Department has historically used a four year audit cycle, it is concluded that the five-year retention period is necessary and reasonable, Moreover, there needs to be some continuity in retaining reports from one rule to another. Thus the five year requirement is necessary and reasonable. That is not to say that there could not be cases where records

were properly destroyed under prior rules which could be within the five-year provision in this rule. If there are cases where that has happened, the facility will not be subjected to retroactive penalties. Therefore, it is concluded that this item is necessary and reasonable.

9553.0035, subp. 5, Item B.

53. This rule requires ICF/MRs to document all consultant, professional, and purchased service contracts. Under the rule they must maintain copies of all such contracts, and invoices relating to the services provided pursuant to them. The documents must include the vendors name and address, the name of the person who performed the services, the dates of service, a description of the services provided, the unit cost of the services and the total cost of the services performed. Ms. Harris suggested that if such information is unavailable, the facility should only be required to document its good faith efforts to obtain it. The Department rejected that suggestion on the grounds that a facility should not be entering into contracts that do not contain the information specified in the rule. For the reasons stated by the Department, it is concluded that the rule is necessary and reasonable as proposed. Since the rule has prospective effect only, except to the extent that it may repeat requirements in Rule 53T, facilities will be able to comply with it. Situations may arise where services were provided before the effective date of the requirement and the required information may not be available. The obligations of a provider in such situations will depend on the rules in effect at the time those services were provided. Under these circumstances, the Administrative Law Judge concludes that the Department's refusal to add a good faith provision to the rule changing a provider's prospective obligations is appropriate, necessary and reasonable.

9553.0035, subp. 5, Item C.

54. Under this item, compensation for services performed by individuals must be documented on payroll records. The payroll records must be supported by time and attendance or equivalent records for individual employees. Ms. Harris criticized this requirement. She noted that many facilities have salaried employees who assume, and are paid to assume, responsibilities and complete tasks, and not to work a fixed number of hours. She also argued that the rule should be more specific regarding the kinds of records facilities must maintain. The requirements in this item are necessary and reasonable. They simply require facilities to keep records of the amount of compensation paid to employees and records showing the days and the hours they worked. If compensation is to be classified to more than one cost category, time distribution records showing where those services were performed must be maintained pursuant to part 9553.0030, so that classification can be verified. The rule does not require salaried employees or professional staff persons to work 40 hours a week or eight hours a day, and it does not require that facilities keep detailed logs showing how each minute's time was spent: time distribution requirements are governed by other rules. However, the rule could be clearer on this point. Therefore, it is recommended that the Department adopt the following language in place of the first two sentences of item C:

> Payroll records must be maintained by a facility and must show the amount of compensation paid to each employee and the days and hours worked.

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